

Message Text

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ACTION TRSE-00

INFO OCT-01 NEA-10 ISO-00 EB-08 L-03 NSC-05 INR-10
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FM AMEMBASSY CAIRO
TO SECSTATE WASHDC 7868

C O N F I D E N T I A L SECTION 1 OF 2 CAIRO 10619

C O R R E C T E D C O P Y - PARA 2, LINES 14 & 21

E.O. 11652: GDS
SUBJECT: IMF-GOE NEGOTIATIONS

REF: CAIRO 10538

1. SUMMARY: AS FOLLOW-UP TO EARLIER DISCUSSION, MINISTER OF ECONOMY GAVE AMBASSADOR COPIES OF RECENT KAISSOUNI/IMF CABLE EXCHANGES ON NEGOTIATIONS OF A THREE-YEAR EXTENDED FUND FACILITY (EFF). MINISTER EXPRESSED HOPE THAT USG WOULD BE ABLE TO URGE IMF TO AGREE TO GOE POSITION. WE HAVE NOW ALSO BEEN PROVIDED DETAILS OF PRICE INCREASES GOE STATES IT PLANS TO IMPLEMENT. OUR REVIEW OF KAISSOUNI/IMF CABLE EXCHANGE INDICATES THAT IMF HAS ACCEPTED GOE PROPOSED MAGNITUDE OF PRICE INCREASES DURING 1978 (LE 157 MILLION) BUT IS INSISTING ON AGREEMENT FOR ADDITIONAL LE 150 MILLION INCREASE IN 1979. GOE IS UNWILLING COMMIT ITSELF TO A QUANTITATIVE 1979 LEVEL, ALTHOUGH STATES ITS QUALITATIVE OBJECTIVE OF PRICE INCREASES IN 1979 IS THE SAME AS THAT OF IMF. BASIC AGREEMENT ON OTHER ELEMENTS OF PROPOSED 1978 REFORM PROGRAM APPEARS TO EXIST. WE WILL SEEK TO DETERMINE IF FURTHER PROGRESS TOWARD CONCLUSION OF AN EFF IS POSSIBLE. IF NOT, NEGOTIATION OF A ONE-YEAR STANDBY MAY BE THE ONLY ALTERNATIVE. END SUMMARY.
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2. OUR UNDERSTANDING OF IMF ASSESSMENT OF ECONOMIC SITUATION IS THAT SUBSTANTIAL PRICE REFORM IS NECESSARY (A) TO RESTORE A RATIONAL BALANCE AMONG PRICES IN EGYPT AND (B) TO ENABLE PUBLIC ENTERPRISES TO COVER COSTS OF THEIR OPERATIONS AND THEREBY AVOID CONTINUING HEAVY RELIANCE ON INFLATIONARY DOMESTIC CREDIT. INFLATION

OF NON-PRICE CONTROLLED COMMODITIES HAS EXCEEDED 20 PER CENT ANNUALLY OVER PAST FEW YEARS WHILE MOST CONTROLLED COMMODITIES HAVE LAGGED BEHIND BY SUBSTANTIAL AMOUNT. PRICE DIFFERENTIALS HAVE BECOME LARGE WITH SERIOUS DISTORTIONS IN ECONOMY RESULTING. IN IMF VIEW, POSTPONING OR REDUCING PROGRAM OF PRICE INCREASES FOR CONTROLLED COMMODITIES WILL RESULT IN DIFFERENTIALS BECOMING LARGER WITH ULTIMATE ADJUSTMENT EVEN MORE TRAUMATIC TO SOCIETY. AT SAME TIME IMF RECOGNIZED THAT COMMODITIES THAT ARE PARTICULARLY IMPORTANT TO LOWER INCOME GROUP MUST CONTINUE TO BE HANDLED SO AS TO PROTECT THEIR PURCHASING POWER. IT ALSO ARGUED THAT INCREASED PRICES AT POINT OF MANUFACTURE WILL NOT ALWAYS RESULT IN INCREASED CONSUMER PRICES BECAUSE CURRENT RETAIL PRICES IN SOME INSTANCES ARE HIGH DUE TO BLACK MARKET WINDFALL PROFITS (CEMENT IS AN EXAMPLE) WHICH WOULD BE REDUCED BY PROPOSED PRICE INCREASES.

3. REGARDING MAGNITUDE AND COMPOSITION OF PROPOSED PRICE INCREASES, OUR ASSESSMENT OF GOE PROVIDED DATA INDICATES THAT LE 107 MILLION IN PRICE INCREASES PROPOSED BY GOE INCLUDE SUBSTANTIAL AMOUNT OF INTERMEDIATE COMMODITIES AS WELL AS RELATED FINISHED PRODUCTS (E.G., YARN, TEXTILES, AND GARMENTS). (ONLY PRICE INCREASES FOR THE FINAL PRODUCT IN THESE INSTANCES WOULD IMPACT DIRECTLY ON RETAIL CONSUMER.) PROPOSED COMMODITY PRICE INCREASES FOR THE PUBLIC ENTERPRISES AVERAGE 30 PER CENT

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CENT FOR THE SPINNING, WEAVING, AND GARMENTS INDUSTRY WITH A 65 PER CENT INCREASE IN THE PRICE OF YARN AND ALL OTHER PRICE INCREASES RANGING BETWEEN 25 PER CENT AND 40 PER CENT. PRICE INCREASES IN THIS ONE SUB-SECTOR CONSTITUTE 74 PER CENT OF TOTALITY OF INCREASES PROPOSED BY GOE FOR PRICE CONTROLLED COMMODITIES. INCREASES IN THE FOODSTUFFS SECTOR AVERAGE 1 PER CENT, WITH NO INCREASE IN MOST COMMODITIES AND THE ONLY SUBSTANTIAL INCREASE BEING 65 PER CENT FOR CHOCOLATE. CHEMICAL INDUSTRIES INCREASES AVERAGE 2 PER CENT WITH A SUBSTANTIAL NUMBER OF PRICE DECREASES PROPOSED. PRICE INCREASES FOR THE BASIC METAL AND EQUIPMENT INDUSTRIES AVERAGE 11 PER CENT WITH INCREASES ON MOST ITEMS LESS THAN 10 PER CENT; ROLLED STEEL AND IRON BARS ARE INCREASED 13 PER CENT AND 14 PER CENT RESPECTIVELY. THERE ARE INCREASES BETWEEN 22-27 PER CENT FOR TV'S, LAMPS, REFRIGERATORS, AND BUSES; BETWEEN 31 - 35 PER CENT FOR WASHING MACHINES, TRACTORS, AND DRY BATTERIES; AND 50 PER CENT FOR WET BATTERIES. GOE/IMF EXCHANGES DO NOT APPEAR INCLUDE REFERENCE TO PRICE INCREASES OF NON-INDUSTRIAL COMMODITIES WHICH EITHER HAVE ALREADY OCCURRED OR ARE UNDER DISCUSSION. WE WILL SEEK TO DETERMINE WHETHER THIS IS

INTENTIONAL OR WHETHER GOE IS INADVERTENTLY NOT MAKING
AS GOOD A CASE FOR ITSELF AS IT MIGHT.

4. REGARDING ROLE OF PRICE INCREASES AS MEANS TO REDUCE
INFLATIONARY USE OF DOMESTIC CREDIT, IMF ARGUMENT IS
BASICALLY THAT TO EXTENT PUBLIC ENTERPRISES CAN'T COVER
THEIR CDSTS THROUGH SALES INCOME, THEY CURRENTLY OBTAIN
EITHER BUDGETARY SUBSIDIES OR CREDIT. BOTH OF THESE ARE
DIRECTLY INFLATIONARY AND CONTRIBUTE TO OVERALL DEMAND
PULL THAT RESULTS IN INCREASES IN PRICES OF COMMODITIES

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ACTION TRSE-00

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FM AMEMBASSY CAIRO

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C O N F I D E N T I A L SECTION 02 OF 02 CAIRO 10619

C O R R E C T E D C O P Y (TEXT--PARA SIX)

DEPT ALSO PASS AID

THAT ARE NOT PRICE CONTROLLED OR THE DEVELOPMENT OF
BLACK MARKETS FOR THOSE THAT ARE CONTROLLED. CRUDELY
PUT, BY SEEKING TO HOLD DOWN SOME PRICES, THE GOVERNMENT
IS CAUSING OTHER PRICES TO INCREASE MORE RAPIDLY. IN
THIS CONTEXT, RATE OF DOMESTIC CREDIT EXPANSION, SIZE
OF BUDGETARY DEFICIT, AND MAGNITUDE OF INCREASE IN CON-
TROLLED PRICES ARE INTER-RELATED WHOLE. SHOULD NOTE
THAT IMF ORIGINALLY THOUGHT THAT IMPLEMEN-
TATION OF GOE PROPOSED PRICE INCREASES WOULD RESULT IN
EQUIVALENT REDUCTION IN DEFICIT (WHICH THEY OTHERWISE
CONSIDERED LARGE AND IN ITSELF CAPABLE OF CAUSING A 25
PER CENT INCREASE IN THE MONEY SUPPLY). IN FACT, IT IS
OUR UNDERSTANDING THAT BUDGET PROJECTION ALREADY INCLUDED
ANTICIPATED PRICE INCREASES AND NO DEFICIT REDUCTION
WILL RESULT FROM PROPOSED PRICE CHANGES.

5. COMMENT: AS REPORTED REFTTEL, THERE SEEM TO BE LACK
OF CLARITY ON WHEN AND HOW IMF AND GOE WILL PROCEED TO

SEEK TO REDUCE DIFFERENCES OF VIEW WHICH EXIST. IMF
APPEARS FULLY PREPARED TO PROVIDE A FURTHER ONE-YEAR
STANDBY ON BASIS OF CURRENT GOE PROPOSALS, BUT GOE
FEELS STRONGLY THAT FOR ITS OWN INTERNAL ECONOMIC DIS-
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CIPLINE AN EFF IS ESSENTIAL, BUT IS UNWILLING TO GIVE
FURTHER ON THE ONE OUTSTANDING ISSUE, AGREEING TO
SPECIFIC QUANTITATIVE PRICE INCREASES IN 1979.

6. WE NOTE ENCOURAGING FACT THAT EVERYTHING ELSE SEEMS
TO BE IN PLACE FOR EFF. AGREEMENT REPORTEDLY HAS BEEN
REACHED ON (A) REDUCTION IN NUMBER OF COMMODITIES SUB-
JECT TO PRICE CONTROL TO THOSE HAVING MAJOR IMPACT ON
COST OF LIVING OF LOWER INCOME GROUPS; (B) INCREASE IN
INTEREST RATES BY TWO PERCENTAGE POINTS BY END OF 1978;
(C) UNIFICATION OF PARALLEL AND OFFICIAL FOREIGN EXCHANGE
MARKETS BY JANUARY 1, 1979 FOR TRANSACTIONS WITH IMF
MEMBER COUNTRIES; AND (D) SUBSTANTIAL EXPANSION OF OPEN
GENERAL IMPORT LICENSING SYSTEM. ONLY CERTAIN DETAILS
OF PRICE POLICY REMAIN AT ISSUE.

7. FROM OUR PERSPECTIVE, WE FULLY AGREE THAT AN EFF IS
DESIRABLE, BUT IN REVIEWING PRICE CHANGES WHICH GOE
PROPOSES, WE ALSO RECOGNIZE MORE CLEARLY THE
CONCERNS FELT BY IMF. WE BELIEVE IT IS NECESSARY, NOW
THAT WE HAVE MORE DETAILS AVAILABLE, TO EXPLORE FURTHER
WITH GOE JUST WHY THEY ARE UNWILLING TO TRY TO TAKE
FURTHER STEPS TO ACCOMMODATE TO IMF DESIRES REGARDING
1979, AND WE WILL ALSO SEEK TO DETERMINE WHETHER THERE
ARE NOT IN FACT SOME PRICE INCREASES TAKING PLACE WHICH
RE NOT BEING FULLY RECOGNIZED IN THE GOE-IMF DIALOGUE.
WE WOULD HOPE FROM THESE CONVERSATIONS THAT SOME
FURTHER ROOM FOR IMF-GOE NEGOTIATIONS MIGHT COME ABOUT.
HOWEVER, IF THE APPARENT GAP BETWEEN GOE AND IMF CANNOT
BE BRIDGED, IT MAY PROVE NECESSARY TO CONSIDER URGING
GOE TO MOVE TOWARDS ONE-YEAR STANDBY PRIOR TO JUNE CG
MEETING. EILTS

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NOTE BY OC/T: AID ONLY TAKE FOR ORIGINAL MESSAGE.

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